New Issue: Honolulu (City & County of) HI Sewer Enter.

MOODY'S ASSIGNS Aa3 RATING AND STABLE OUTLOOK TO CITY AND COUNTY OF HONOLULU'S SENIOR LIEN WASTEWATER SYSTEM REVENUE BONDS

$556.3 Million of Senior Lien Debt Affected, Including Current Offering

Water/Sewer
HI

Moody's Rating

ISSUE	RATING
Waste Water System Revenue Bonds (First Bond Resolution), Senior Series 2006A, 2006 B, and 2006 C	Aa3

Sale Amount	$278,910,000
Expected Sale Date	08/22/06
Rating Description	Senior Lien Wastewater System Revenue Bonds

Opinion

NEW YORK, Aug 21, 2006 -- Moody's Investors Service has assigned an Aa3 rating and stable outlook to the City and County of Honolulu's Wastewater System Revenue Bonds (First Bond Resolution), Senior Series 2006A, 2006B and 2006C. At this time, Moody's also affirms the Aa3 rating on the system's $277.4 million of outstanding senior lien bonds and the A1 rating on $460.1 million of outstanding junior lien bonds. The ratings are based primarily on satisfactory coverage of debt service provided by existing revenues, the city's recent approval of substantial multi-year rate increases to support system obligations, continuing progress on the system's sizable capital improvement plan which will require additional borrowing in the coming years, and the favorable economic base served by the wastewater enterprise. The stable rating outlook is based on Moody's expectation that, despite the presence of significant future borrowing plans, the wastewater system will maintain favorable financial performance consistent with the city's conservative financial and debt policies.

SYSTEM REVENUES PROVIDE SATISFACTORY DEBT SERVICE COVERAGE; CITY ADOPTS MULTI-YEAR RATE INCREASES

Moody's believes that existing system revenues provide satisfactory coverage of revenue bond debt service; pledged net revenues for fiscal 2005 provided 1.21 times coverage of peak debt service on the senior lien bonds. Current year coverage is much stronger and is expected to remain sound for both first and second lien obligations. In fiscal 2005, first lien coverage was high at 4.40 times, while coverage of first and second lien bonds combined was 2.07 times. However, including reimbursable general obligation bonds and SRF loans, 2005 coverage of all system obligations was only 1.06 times, only slightly above the city's 1.05 minimum target level. The city's long-term financial projections indicate that coverage levels will continue to comply with the city's adopted policy calling for a satisfactory 1.6 times on senior lien bonds and 1.25 times on combined senior and junior lien bonds; including reimbursable general obligation bonds and SRF loans, projected coverage of all system obligations is expected to exceed 1.05 times.

Moody's notes that the city's adoption of multi-year wastewater system rate increases last year marked an important achievement in ensuring adequate bondholder security going forward. As part of his inaugural budget, the Mayor proposed rate increases of 25% in fiscal 2006 and 10% annual increases thereafter through fiscal 2011; in June 2005, the City Council passed an ordinance adopting these increases. Even after the 25% rate increase in fiscal 2006, wastewater rates remain comparable to the rates of other major urban systems on the mainland.

SUBSTANTIAL CAPITAL IMPROVEMENT PLANS ADDRESS REGULATORY CONCERNS; MAJORITY TO BE FUNDED WITH ADDITIONAL BORROWING

The system provides wastewater services for approximately 70% of the island of Oahu's population which includes Honolulu (general obligation bonds rated Aa2/stable). The customer base is diversified with residential users representing 77.0% of the system's fiscal 2006 revenues while the ten largest customers accounted for only 6.15% of 2005 revenues. The system operates eight wastewater treatment plants serving an area of approximately 500 square miles.

Since 1991, the Environmental Protection Agency, the State of Hawaii, and several environmental groups have filed various legal and regulatory actions against the City and County of Honolulu alleging violations of the federal Clean Water Act and several of the permits held by the wastewater department. Honolulu has entered into four consent decrees in connection with the settlement of these actions which establish a required compliance schedule for project implementation. Among other things, the consent decrees require that Honolulu rehabilitate and expand certain existing facilities and construct new facilities. In addition to actions taken to date, the wastewater department has developed capital improvement plans covering periods of five, ten and twenty years, in part to comply with the existing consent decrees. The long-range capital program will also address safety and public health, permit compliance, system expansion and reliability issues. Capital expenditures over the next five-year period are estimated to total $933.2 million, approximately $854.8 million of which is expected to be funded from the proceeds of additional senior and junior lien bonds, including the current offering. As a result, the system's 2005 debt ratio of 54.8% is expected to grow over time, but remain manageable.

As with other wastewater treatment systems, the City and County of Honolulu faces evolving state and federal regulations on treatment and discharge standards. The potential for stricter standards in the future adds a measure of uncertainty to the system's future capital needs and additional borrowing plans beyond those currently contemplated by management. However, Moody's believes that the phased aspects of the system's twenty-year capital improvement program will provide management with a fair degree of flexibility to address potential future changes in regulatory requirements.

ROBUST ECONOMY BENEFITS FROM STRONG PERFORMANCE OF TOURISM SECTOR

Honolulu's economy has performed remarkably well in recent years, particularly given the sharp declines in travel to Hawaii for a brief period following the 9/11 terrorist attacks. Unemployment in Honolulu, at 2.7% in May 2006, remains among the lowest in the nation. Rising real estate values have had an important influence on the local economy, but a variety of other factors have contributed as well. Visitor traffic has improved significantly since the steep declines suffered immediately following the 9/11 terrorist attacks. Eastbound (primarily Asian) and other international traffic still lags historical performance, but Westbound traffic (primarily from the U.S. West and East coast markets) has more than offset these losses. Hawaii remains a unique and attractive tourist destination and officials have been successful in niche marketing the island. Examples include sports- and eco-tourism as well as a growing inter-island cruise business, all of which attract a higher percentage of first time visitors and stimulate longer average stays. Moody's notes that airline capacity serving the Hawaii tourism market relies on the health of the financially volatile airline industry. Moody's also notes improving diversity in the Honolulu economy which includes the military, health care, and banking sectors as important contributors. The city's successful efforts to finance light rail development through a recently-authorized general excise tax should help stimulate further housing and business development in west Oahu, especially in the Kapolei and Ko Olina areas. Despite the moderating influence of many tourism-related service jobs, wealth indicators in Honolulu are also favorable with per capita and median family income at 101.9% and 120.1% of the U.S., respectively.

STANDARD LEGAL PROVISIONS BOLSTERED BY ADOPTION OF FORMAL FINANCIAL POLICIES

Legal provisions include covenants to maintain a Debt Service Reserve Fund, equal to maximum annual debt service, on both liens of bonds and stipulate the maintenance of rates and charges sufficient to generate net revenues at least equal to 1.20 times the amount needed to pay debt service on the senior lien bonds and 1.10 times on combined senior and junior lien debt service. A similar covenant is provided for the issuance of additional parity bonds under both liens although officials report that most future borrowing is expected to be issued through the senior lien. The reimbursable general obligation bonds, as well as the debt service on the system's state revolving fund loans, are secured by a lien on net system revenues which is subordinate to the lien created by the junior lien bonds.

Legal provisions are significantly bolstered by the formal adoption of conservative debt and financial operating policies by the city council which require compliance with annual targets of 1.6 times coverage on the senior lien bonds and 1.25 times on first and second lien bonds combined. In addition, the city council resolution incorporates a favorable three month operating and maintenance reserve fund policy which will serve to insulate the system from unexpected events. Moody's expects that the system will comply with these more stringent operating policies as opposed to the levels stipulated by the legal covenants of the bond documents.

Outlook

The stable rating outlook is based on Moody's expectation that, despite the presence of significant future borrowing plans, the wastewater system will benefit from approved rate increases and maintain favorable financial performance consistent with the city's financial and debt policies.

KEY STATISTICS:

Service area population, 2005: 876,156

Operating ratio, 2005: 60.2%

Senior lien debt service coverage, 2005: 4.4x

Combined senior and junior lien debt service coverage, 2005: 2.1x

Peak senior lien debt service coverage by FY 2005 net revenues: 1.2x

Peak senior lien debt service coverage by FY 2006 net revenues: 1.4x

Debt ratio, 2005: 54.8%

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